# PLUCKING THE GOOSE

**CHANGES IN THE INTERNATIONAL TAX LANDSCAPE MAY HAVE SIGNIFICANT IMPLICATIONS FOR CORPORATE TREASURIES, SAY GRAHAM ROBINSON AND EDEL GUNNING**

Over the past year, there has been increasing public and political interest in the tax affairs of large companies, with the tax structures of many multinationals attracting negative publicity. Individual governments, driven by a reduced capacity to generate taxes, along with the European Commission and the Organisation for Economic Co-operation and Development (OECD), have called into question the tax profile of a number of multinational groups and, subsequently, the international tax system itself.

The need for a review of whether the international tax system remains fit for purpose has been driven by a number of factors, including new business models arising as companies operate on an increasingly global basis. Alongside this, competition between countries for inward investment continues to feature in governments' tax policies.

This article highlights what potential changes might mean for the treasury function.

## The OECD initiative

In order to address concerns that the global tax system does not reflect current business operations, the OECD published an *Action Plan* in July 2013, setting out specific actions that it believes should be taken to enable governments to address the challenge of base erosion and profit shifting (BEPS).

The fundamental aim of this initiative is to ensure that profits are taxable where economic substance and business activities are located. The project covers a broad range of areas. Of most relevance to corporate treasury are those that aim to eliminate financial arrangements that mitigate taxable profits, either through complex structures (hybrids) or by mitigating withholding taxes (WHT) (treaty abuse). These terms are broadly defined, and apply to many features of group structures that would not generally be classed as tax avoidance.

The OECD has issued discussion papers and engaged in public consultation in relation to these papers this year. Finalised papers are expected in September. Although the papers are not binding, they give an indication of likely developments in international and domestic legislation.

## Prevention of treaty abuse

The proposals on treaty abuse seek to modify existing international tax rules in order to more closely align the allocation of income with the economic activity that generates that income, restricting access to tax treaties to territories where companies have real activities.

The discussion paper recommends allowing a company to benefit from a reduction in WHT under a tax treaty, only if the receiving company has its main listing in the territory concerned, or undertakes an 'active business' there.

'Active business' may well not include treasury functions. Therefore, groups with treasury operations in a territory other than that of their ultimate parent may find their access to tax treaties is limited, increasing WHT.

## The taxation of hybrids

Where a treasury function is involved in financing activities, it may also be impacted by changes in relation to hybrids. These proposals target arrangements that create a low effective tax rate or a deferral of the tax charge, through either entities or financial instruments that are treated inconsistently in different territories.

The OECD proposals seek to neutralise the effect of hybrids, by enforcing symmetrical treatment. Although there is some acknowledgement that hybrids may be used for purely non-tax reasons, it is also suggested that the rules should apply automatically, without testing whether there is a tax-avoidance purpose for the arrangement. This contrasts with rules such as the UK's anti-arbitrage rule that currently only applies in situations where tax reduction is a main purpose.

Any company using instruments for funding will need to consider the effect of the proposals carefully.

## Unilateral actions by territories

At first it was expected that countries would await the finalisation of the OECD papers before implementing changes to domestic law. Unilateral changes are now occurring in a number of countries, however.

Austria, France, Mexico and Norway have introduced rules to limit interest deductions in certain circumstances, while Canada and the Netherlands have amended the conditions that companies must satisfy in order to qualify for the benefits of double tax treaties. Other territories have taken steps in response to other key areas.

In addition, the European Commission has proposed changes to the Parent Subsidiary Directive, which limits WHT on intra-EU interest and dividend flows, to include an anti-abuse provision. There are also proposals to address tax mismatches arising under hybrid instruments.

## New transactional taxes and information-sharing requirements

A related trend is the introduction of new transactional taxes and reporting requirements. In 2013, it was announced that 11 EU member states (including Germany, France, Italy and Spain) would introduce a financial transactions tax.

At a meeting of European finance ministers in May, it was confirmed that a phased approach will be required, beginning with a tax on equities and equity derivatives. This is likely to affect treasury transactions where either party is in one of these states. While exemptions for intragroup and hedging transactions have been discussed, it is not yet clear what form these might take. A lot of work remains to be done in advance of the introduction of the first phase by 1 January 2016.

In order to combat cross-border tax evasion by US residents using foreign accounts, the US government announced the introduction of the Foreign Account Tax Compliance Act (FATCA) legislation in 2010. Under this legislation, financial institutions (wherever they are tax-resident) have certain US reporting requirements. Failure to fulfil these requirements will result in WHT being applied to US-sourced payments.

FATCA regulations were issued in 2013, and largely came into effect on 1 July 2014. While the law is primarily aimed at the financial services industry, group treasury entities in other industries may, in some circumstances, be drawn into the rules. Treasurers need to confirm their group's position, and be prepared to certify their status to counterparties.

Following the introduction of FATCA, the G8 and G20 Leaders committed to establish a global model for the automatic exchange of financial account information to improve cross-border tax compliance.

This model seeks to increase transparency by establishing a global methodology for sharing data in relation to financial assets among tax authorities. As a result, taxpayers with offshore assets, and financial institutions that hold them, will all face new challenges under the OECD's Common Reporting Standard, which was approved in July. The first exchanges of information are expected by the end of September 2017.

### KEY CHANGES TO INTERNATIONAL TAX

- **The global pressure to reform the international tax system could have a real impact on the treasury functions of large companies.**
- **Current proposals would impose WHT on many intragroup payments to treasury centres.**
- **Interest deductibility may be impacted where 'hybrid' entities or instruments are present in structures.**
- **Transaction taxes are likely to increase.**
- **Many territories are implementing their own laws and/or practice changes rather than waiting for international consensus.**
- **Treasurers need to be ready to act as these changes are implemented.**

## What next?

The OECD proposals discussed above, together with the output from other BEPS workstreams, were considered by G20 Finance Ministers in September and are due to be considered at the G20 Leaders Summit in Brisbane. A deadline of September 2015 has been set for the finalisation of the next set of proposals, including the design of domestic rules to limit the reduction of a company's tax base through interest deductions and other financial payments. The final proposals will be released in December 2015. It is likely that discussion drafts will start to appear later this year.

Meanwhile, it seems likely that many countries will continue to pursue a domestic agenda of increasing tax revenues from the financial transactions of multinational companies. Treasurers should monitor developments, and be prepared to restructure their operations, in a way that can still support the business, where this is made necessary by the changes afoot.

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